

than its retail operation. This outcome is unacceptable since it provides Ameritech Illinois with reduced incentive to increase efficiency and actively compete in the retail market. (*Id.* at 20).

Position of the Intervenor

AT&T, MCI, WorldCom and Sprint all oppose the inclusion of a residual in pricing for UNE, interconnection, transport and termination services. AT&T/MCI argue that the inclusion of residual revenues in the price of UNEs is in direct violation of the FCC Order, which requires that UNEs be priced based on the incumbent LEC's forward-looking efficiently incurred economic cost to provide them. The FCC expressly excluded the inclusion of these historical or embedded "costs" because they are not, by their very nature, forward looking efficiently incurred "costs," or economic costs. (FCC Order ¶¶ 704-705; 47 C.F.R. §§ 51-505(d)(1) and 51-505(d)(3)); (Staff Ex. 3.00, p. 5). AT&T/MCI state that the Illinois Cost of Service Rules also mandate that embedded or historical costs be ignored in determining the LSRIC of a service because they are not forward-looking or based on least cost technology. Illinois Cost of Service Rules, Sections 791.20(a), (c).

AT&T states that the residual, as defined and calculated by Ameritech Illinois, constitutes Ameritech Illinois' revenues for a given period of time and leads to the automatic recategorization of excess earnings as costs regardless of whether they really are costs to Ameritech Illinois' operations. (AT&T Ex. 1.1 at 4-5). AT&T notes that Ameritech Illinois is under alternative regulation which it knowingly entered into, whereby it forgoes the ability to be kept whole in return for the opportunity to earn profits which are unlimited by regulation. AT&T maintains that Ameritech Illinois wants the best of both regulatory worlds (rate of return regulation and alternative regulation) and that to restore logic to this proposal, one must consider the profits that Ameritech Illinois will earn when it enters the interLATA market. (AT&T Ex. 1.1 at 5-6). MCI adds that Ameritech Illinois elected incentive regulation as opposed to rate of return regulation, in order to obtain certain flexibilities enjoyed by firms in competitive markets. The quid pro quo is that Ameritech Illinois should stand up to the challenge of competing for revenues rather than appealing to the Commission to ensure recovery of its embedded inefficiencies. (MCI Ex. 2.1 at 18-19).

AT&T states that the Commission has already rejected the notion that Ameritech Illinois should be made whole as a result of the impact of competition. AT&T references the Commission's Customers First Order, where the Commission concludes that, "...any changes in revenues which are attributable to the impact of enhanced competition do not qualify for exogenous treatment under the alternative regulation plan." (ICC Order in Docket 96-0046 et al., at 121 and AT&T Ex. 1.1 at 5).

MCI concludes that the inclusion of the residual in the rates for UNE and interconnection services is inconsistent with Section 252(d)(1) of the federal Act which MCI claims prohibits setting rates for UNEs with reference to historic costs. This is

because Ameritech Illinois' 1994 capped residual constitutes an historic cost. (MCI Ex. 2.1 at 5). MCI also argues that Ameritech Illinois is already recovering all of its residual costs from its current service offerings. As a result, excluding such costs from UNE and interconnection rates would not constitute renegeing on the regulatory commitment to Ameritech Illinois. (MCI Ex. 2.1 at 9).

MCI adds that residual costs are not causally related to the provision of UNEs and interconnection services. As a result, they should not be recovered by such items. (MCI Ex. 2.0 at 121). It adds that residual cost pricing is incompatible with competitive markets, because it introduces price distortions, induces inefficient entry, perpetuates embedded inefficiencies, and deprives end users from the full benefit of competition. Residual cost pricing would also discourage use of Ameritech Illinois' unbundled facilities where Ameritech is in fact the low cost provider. (MCI Ex. 2.1 at 15-16). MCI also states that residual cost pricing disadvantages new entrants because UNEs are more expensive than the facilities used by Ameritech Illinois itself. (MCI Ex. 2.1 at 17). Finally, residual cost pricing is a make whole provision for Ameritech Illinois that is not enjoyed by Ameritech Illinois' competitors. (MCI Ex. 2.1 at 18).

WorldCom states that the residual, as defined and calculated by Ameritech Illinois, does not represent costs at all. Rather it represents residual revenues or the difference between economic costs and revenues. (WorldCom Ex. 1.2 at 27).

WorldCom concludes that the allocation of the residual to such services would change the cost basis upon which UNE, interconnection, transport and termination rates are set, from a forward looking cost methodology to a fully distributed cost methodology. WorldCom notes that the Commission has rejected fully distributed cost methodologies when setting rates. (*Id.* at 27 and Tr. 1956 line 3 to Tr. 1994 line 13). WorldCom also contend that residual cost recovery amounts to a fully distributed cost methodology in violation of the Commission's Order on Remand in Docket 89-0033.

WorldCom also states that the difference between economic costs and the residual can be attributed to a number of factors, including excess profits. WorldCom adds that this is particularly true since Ameritech Illinois was granted alternative regulation treatment. (*Id.* at 28).

Finally, WorldCom states that it is anticompetitive to create a pricing structure for UNEs that assures Ameritech Illinois of unregulated profits, regardless of whether it makes them by retaining consumers or by imposing charges on competitors which have been successful attracting customers. (*Id.* at 28).

TCG states that Ameritech Illinois has not demonstrated that it would lack a reasonable opportunity to recover its residual through its retail rates, as specified in the Illinois price cap plan. To make such a showing, Ameritech Illinois would have to prove that its incremental cost pricing of UNEs would, alone, allow competitors to sufficiently undercut Ameritech Illinois' retail prices so that its embedded revenue streams would

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be subject to greater than normal competitive risks. TCG concludes that Ameritech Illinois cannot make such a showing. TCG adds that market forces will not immediately bid down retail service prices to the economic cost levels. (TCG Ex. 1.0 at 26-27).

In Response, Staff disagrees with AT&T's interpretation of the Commission's alternative regulation of Ameritech Illinois as constituting a complete departure from rate of return principles used to regulate Ameritech Illinois in the past. This is evidenced by the fact that when setting the rates going into Ameritech Illinois' price cap mechanism, the Commission started with Ameritech Illinois' 1992 test year revenue requirement, and then used the resulting rates as the starting rates in the price cap mechanism. (See, Order in Docket 92-0448/93-0239 Consol. at 96-178 and Staff Ex. 3.02 at 8-9). Staff also disagrees with the relevance of AT&T's reference to the Commission's Customers First proceeding noting that the Commission was referring to exogenous treatment of revenue losses associated with retail competition.

Staff also disagrees with MCI's contention that there is no cost causality between Ameritech Illinois' residual costs and its network elements and interconnection services. Staff notes that Ameritech Illinois' past investments in its network infrastructure have allowed it to develop the network elements and economies of scale from which new entrants will benefit. To the extent that Ameritech Illinois' past costs were higher than forward looking costs, Ameritech Illinois' residual is an historical cost associated with building those network elements and interconnection services. (See, Staff Ex. 3.00 at 18).

Further, Staff disagrees with MCI's interpretation of Section 252(d)(1)(A) regarding the prohibition against inclusion of the residual in the rates for UNEs and interconnection services. Section 252(d)(1)(A) prohibits state commissions from engaging in a rate of return type analysis or proceeding to determine the appropriate rates for an incumbent LEC's UNE and interconnection service rates. (Staff Ex. 3.02 at 10). The FCC provides a similar interpretation of Section 252(d)(1) in its FCC Order. (FCC Order at ¶ 704 and Ameritech Illinois Ex. 1.0 at 15). According to Staff, the inclusion of a portion of Ameritech Illinois' residual in its rates for UNEs and interconnection services can not be construed as engaging in such a proceeding. (Staff Ex. 3.02 at 10).

Staff argues that MCI provides little rationale as to why the recovery of Ameritech Illinois' residual should be required or imposed solely on Ameritech Illinois' retail end users. Carrier customers will benefit as much from Ameritech Illinois' economies of scale as its end users have. (Staff Ex. 3.02 at 11).

Staff also disagrees with MCI's conclusion that inclusion of the residual in UNE and interconnection rates will introduce price distortions, induce inefficient entry, perpetuate embedded inefficiencies, deprive end users from the full benefit of competition, and discourage use of Ameritech Illinois' unbundled facilities where Ameritech is in fact the low cost provider. At the base of MCI's conclusions lies the implicit assumption that residual costs are uneconomic costs which were inefficiently

incurred by Ameritech Illinois over time. Staff disagrees with that blanket characterization. The fact that past costs incurred to build Ameritech Illinois' network may be higher than forward looking costs by no means indicates that such costs were incurred in an inefficient manner.

Commission Analysis and Conclusion

We reject the inclusion of any "residual" increment to the prices we are establishing for UNEs and interconnection. We conclude that the proposals, in a futile attempt to reconcile the irreconcilable, present a conceptual morass which risks the achievement of the very purpose of this proceeding - to fulfill Congress' intention to facilitate the development of local exchange competition through the establishment of just and reasonable prices for UNEs and interconnection. The advocates of residual-based pricing fail to recognize that there is a fundamental difference between forward-looking economic cost-based pricing and embedded historical or fully distributed cost base pricing. As WorldCom correctly observed, the two are wholly distinct and inconsistent policies for setting prices.

The FCC firmly rejected arguments that the prices must or should include any difference between the embedded costs LECs have incurred and the economic costs of those elements and services, concluding that forward-looking economic cost-based prices would best ensure the efficient investment decisions and competitive entry contemplated by the Act. We agree. To include residual in UNE prices is completely antithetical to competition because competitors would be forced to pay more than the economic costs of the elements they purchase, thereby discouraging competitors as efficient as or even more efficient than the incumbent LEC from entering the market. None of the varied arguments offered in support of the residual increment proposals are persuasive.

Ameritech Illinois' arguments about underdepreciating assets and the regulatory bargain are nothing more than a rehash of the argument it made in the alternative regulation proceeding in which it sought an adjustment to the Price Cap Index formula for a purported "depreciation reserve deficiency." We rejected the argument at that time and it has not improved with age.

Dr. Aron has coined the term "sham unbundling" to describe her concerns about carriers purchasing wholesale services at sub-wholesale rates through purchase of end-to-end, unbundled elements. Other than the label, there is nothing unique about her argument which has not already been considered, and rejected, by the U.S. Court of Appeals, 8th Circuit:

"The petitioners then argue that by allowing a competing carrier to obtain the ability to provide finished telecommunications services entirely through unbundled access at the less expensive cost-based rate, the FCC enables competing carriers to circumvent the more expensive

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wholesale rates that the Act requires for telecommunications services, and thereby nullifies the terms of subsection 251(c)(4)."

The Court goes on to conclude that:

"Although a competing carrier may obtain the capability of providing local telephone service at cost-based rates under unbundled access as opposed to wholesale rates under resale, unbundled access has several disadvantages that preserve resale as a meaningful alternative. Carriers entering the local telecommunications markets by purchasing unbundled network elements face greater risks than those carriers that resell an incumbent LEC's services"

Earlier in this order we rejected Ameritech Illinois' argument that there was a need for a specific relationship between wholesale prices and UNE prices. In light of the Court's ruling we also accord no weight to that argument as support for inclusion of a residual increment to prices.

With respect to the "stranded investment" argument, we believe that the U.S. Court of Appeals 8th Circuit, provided useful insight:

" A carrier providing services through unbundled access, however, must make an up-front investment that is large enough to pay for the cost of acquiring access to all of the unbundled elements of an incumbent LEC's network that are necessary to provide telecommunications services without knowing whether consumer demand will be sufficient to cover such expenditures."

Thus, a new market entrant purchasing an unbundled element faces market uncertainties as does Ameritech Illinois. We see no reason to attach a special premium to Ameritech Illinois' prices to compensate it for its market risks.

The transcript is replete with numerous afterthought adjustments to Ameritech Illinois' original proposal: an adjustment for payphone CPE; an adjustment for access charges; an undetermined adjustment for retirement of the residual. None of these "refinements" inspire any confidence that the resulting residual something is a meaningful calculation. Ameritech Illinois is essentially asking this Commission to embrace these self-described "costs" without knowing what they are or what they consist of, and then to pass them on to the new entrant carrier trying to enter the market.

There is no basis in this record to conclude that economies of scale are not already adequately reflected in Ameritech Illinois' TELRIC prices. Nevertheless, even if we were to conclude that they were not and that they should be reflected as an addition to TELRIC prices, we would need a far more meaningful measure of those economies

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than Staff offers. As TCG noted, the underlying math of Ameritech Illinois' and Staff's proposals means that as the sum of TELRICs decreases, the calculation of the residual increases on a one for one basis; correspondingly, an increase in the sum of TELRICs reduces the residual. Any of the numerous changes to TELRIC calculations which we make will impact the calculation of the residual, and those modifications are unlikely to have had any relationship whatsoever to economies of scale. We could just as easily conclude that the residual reflects any "errors" in Ameritech Illinois' TELRIC calculations which Staff says are also, conceptually, a part of the residual. The same problem exists with respect to stranded investment or Dr. Aron's capital costs and spare capacity.

We also believe that the switch from traditional rate of return regulation to alternative regulation is not as easy to account for as Staff believes. When it is considered that the 1992 revenue requirement is equal to costs plus an allowed rate of return, it must be recognized that the change to alternative regulation modifies every term in the equation. Traditional regulation costs are historical book costs, often modified for known and measurable changes for a specified test year. Alternative regulation essentially severs the link between costs and prices whereas TELRIC attempts to measure economic costs. Traditional regulation defines an explicit authorized rate of return which is only a permissible return, whereas the alternative regulation plan has no limit on earnings whatsoever. Traditional regulation is based on prices and quantities sold in the test year which reflects the monopoly market characteristics of the time. Alternative regulation accounts for sales growth only through operation of the Adjusted Price Index. We are not persuaded that Staff's proposal genuinely reconciles all of these differences.

Our conclusion is perfectly consistent with the Wholesale Order because there, as here, we were excluding a residual increment to the prices being determined pursuant to the statutory standard of measurement ("avoided costs") relevant in that proceeding.

Ameritech Illinois does correctly point out that through judicial interpretation and legislative acquiescence the aggregate revenue test requires a calculation and allocation of a residual. However, the aggregate revenue test is specifically designed to prevent the cross-subsidization of competitive services by non-competitive services. That is a far different objective than the setting of UNE and interconnection prices. Furthermore, at Ameritech Illinois' urging we rejected the notion that the residual was a cost input to be assessed to a particular service, and left recovery of residual to Ameritech Illinois' retail pricing. That conclusion has been affirmed by the Courts.

For all of the above reasons, the Commission rejects any proposal to include residual revenues in UNE prices because to do so would be inconsistent with the FCC guidelines, prior Commission orders and sound economic principles. We note that in its Brief on Exceptions Ameritech Illinois indicates that it is no longer seeking, in this proceeding, a residual increment to the rates otherwise established by this Order.

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I. Sum Of The Parts

Staff

Staff notes that UNEs, interconnection, and transport and termination services are intermediate products utilized in the provision of local service. Staff adds that Ameritech Illinois may be the sole provider of such intermediate products while, at the same time, it competes with its carrier customers in the retail local service market. As a result, Ameritech Illinois must satisfy the PUA's imputation requirements for services classified as competitive with noncompetitive inputs. Staff concludes that the sum-of-the-parts test is consistent with the statutory imputation requirements but is extended to situations where the bundled services have not been reclassified as competitive. (Staff Ex. 3.01, p. 7). For example, during the Customers First proceeding, Ameritech was required to unbundle its loops and ports to be available for purchase by other telecommunications carriers. In addition to the applicability of statutory imputation requirements, the Commission concluded that additional safeguards were needed to protect competitors from potential price squeezes for services still classified as noncompetitive. As a result, the Commission required "that the sum of the 'unbundled portions of the NAL,' in other words, the loops, ports and monthly connection charges, should be priced no more than the total price of the bundled line providing the same services and functionalities." (Order in Docket 94-0096, et. al., at 60 and Staff Ex. 3.01, p. 8).

Staff concludes that the sum-of-the-parts test is equally important in this proceeding because Ameritech's pricing of its UNEs will have a significant effect on the ability of other telecommunications carriers to compete with it in the provision of local service. However, the sum-of-the-parts test needs to be modified to accommodate: (1) the increased array of UNEs that Ameritech Illinois has been required to unbundle and provide pursuant to the Act, and (2) the fact that Ameritech Illinois avoids retail costs in an unbundled environment. (Staff Ex. 3.00, p. 30-31 and Staff Ex. 3.01, p. 7).

Staff proposes that the sum of the parts test should be modified as follows:

Basic Loop charge + Basic line-side port charge (less the cost for vertical features) + Cross connects + Portion of the Service Coordination Fee \leq Wholesale NAL + interstate Subscriber Line Charge

Staff reasons that Ameritech should impute the basic loop, port, cross connects and service coordination fees into its wholesale NAL to account for the fact that retail costs associated with the NAL are avoided in the wholesale environment. This change is needed because Ameritech will not incur retailing costs in providing either UNEs or wholesale services. Further, new entrants will need to incur their own retailing costs to attract customers. New entrants would be placed at a competitive disadvantage if they

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were charged with recovering both their own retailing costs as well as Ameritech's. (Id., pp. 10-11).

Staff notes that the sum-of-the-parts test should be applied on a going forward basis. Further, to satisfy the sum-of-the-parts test, contribution over the TELRIC of UNEs may need to be reduced in certain instances. Staff finds such an outcome appropriate because in the retail and wholesale environments, the NAL contributes a minimal amount to Ameritech's shared and common costs and its residual. It is equally appropriate for UNEs to recover their TELRICs, but provide minimal contribution to Ameritech's shared and common costs and its residual if needed to meet a sum-of-the-parts test. In fact, it seems inherently inconsistent to require competitors to cover more of Ameritech's shared and common costs and its residual through purchase of UNEs than it requires from either its wholesale or retail customers when purchasing a NAL. Thus, the allocation of shared and common costs and its residual should be adjusted if needed.

AT&T and MCI

AT&T emphasizes the importance of imputation and the sum-of-the-parts test in protecting new entrants from potential price squeezes, (AT&T Ex. 1.0 at 12 and 65-66, and AT&T Ex. 2.0 at 16-17) and proposes a two part sum-of-the-parts test. The first part resembles the Commission's current sum-of-the-parts test with some modification. AT&T's first test would require the following:

Loop Rate + Port Rate + Cross Connects + Portion of Service Coordination Fee
+ Collocation Charges + Amortized Portion of Any Applicable Nonrecurring Charges \leq
Wholesale Network Access Line (NAL) + Nonrecurring Revenues

AT&T adds that where the sum-of-the-parts pricing tests are required, Ameritech Illinois should provide a comprehensive list of all rate elements that new entrants must pay to provide the equivalent of Ameritech Illinois' services. Further, rate elements that pertain only to unbundling should be excluded. (AT&T Ex. 2.1 at 3-6).

The second part of AT&T's test would require Ameritech Illinois to piece together the various network facilities needed to provide, at a minimum, local service and impute them into its retail end user local service rates. The network elements would include, but not be limited to, charges for loops, ports, local switching, service coordination, cross connection, common transport, signaling, tandem switching, and all initial service ordering, line connection and other nonrecurring charges to the extent such charges are approved by the Commission. AT&T's proposal would require assumptions regarding usage patterns, location lives, and average number of customers per switch. (AT&T Ex. 2.1 at 5-6).

AT&T recommends that any assumption changes applicable to UNE and interconnection arrangements should be equally applicable to Ameritech Illinois' retail

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services. (AT&T Ex. 1.0 at 39). Finally, AT&T notes that in order for Ameritech Illinois to satisfy imputation testing, Ameritech Illinois may need to reduce markups over TELRIC on a case-by-case basis. (AT&T Ex. 1.0 at 65-66).

In response, Staff supports AT&T's proposal to reduce the markup on UNEs if that is needed to satisfy imputation and sum-of-the-parts requirements. However, Staff asserts that UNE rates must not be reduced below TELRIC to meet such requirements. Staff also agreed with AT&T's proposed inclusion of Ameritech Illinois' rates for loops, ports, cross connects and service coordination in the sum-of-the-parts test. Staff also agrees with the inclusion of the "applicable nonrecurring" charge, to the extent wholesale nonrecurring charge revenues are accounted for on the right hand side of the sum-of-the-parts test equation. Including the wholesale, as opposed to the retail, nonrecurring charge revenue on the right hand side of the equation will allow Ameritech Illinois the flexibility to decrease its retail recurring charge on a short term promotional basis without forcing it to waive that charge for its UNE customers. This is consistent with the Commission's conclusion in the Wholesale Docket whereby Ameritech Illinois was allowed to provide retail promotions without having to decrease the corresponding wholesale rate. However, Staff does not agree to the inclusion of port related nonrecurring charges to the sum-of-the-parts test. This is because when a new entrant purchases a port, it can provide service to one customer. If the customer elects to discontinue receiving service from the new entrant, the new entrant can continue utilizing the same port to provide service to another customer. It would make the test too strict to include that nonrecurring charge on a per customer basis.

Staff also disagrees with the inclusion with the charges for physical collocation in the sum of the parts test. This is because, when a new entrant collocates in an incumbent LEC's central office, such new entrant collocates to provide a wide array of services, including access services. In return, the new entrant is eligible to receive revenues from these services including access revenues. It would make the test too strict to impute portions of physical collocation into the wholesale NAL. (Staff Ex. 3.02 at 29).

Finally, Staff would recommend adding the interstate Subscriber Line Charge to the right hand side of AT&T's equation. This is because the interstate Subscriber Line Charge recovers some of an incumbent LEC's loop costs. Further, in a wholesale service environment, resellers are assessed this charge at no discount and usually pass it on to their customers, collect the funds and remit them to the incumbent. (Id. at 30).

Staff maintains that it would be very difficult to implement the second part of AT&T's proposed test. It says that some of the rates Ameritech Illinois charges new entrants are recurring monthly charges, while others are usage sensitive charges. This creates a problem in attempting to reconcile that portion of the equation with the wholesale service side. As an alternative, Staff recommends that Ameritech Illinois should be required to satisfy a usage sensitive sum-of-the-parts test whereby it lists all

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of its usage sensitive charges related with UNE based entry (including switching, signaling and common transport charges), to all of its usage sensitive charges related with its wholesale services. Since Ameritech Illinois receives access charge revenues in a wholesale service environment, such revenues should also be included in the wholesale service portion of the equation. (Id. at 30 - 31).

Position of CCI

CCI supports the continuation of the sum-of-the-parts test with the modifications recommended by AT&T witness Mr. Webber. In support of its position, CCI states that competitors like itself who seek to serve residential as well as business customers have essentially no alternative to Ameritech Illinois' UNEs. Therefore it is critical to apply an imputation test to the prices Ameritech Illinois charges its competitors for UNEs. (CCI Ex. 1 at 6 and 9 and CCI Ex. 2 at 5-6). CCI provides a list of the additional charges it incurs to obtain loops from Ameritech Illinois. These additional charges include charges for fiber optic terminals, equipment bays (shelves), cable pulling and splicing and project management fees, cross connect panels, and digital loop carriers. (Id. at 3). Finally, CCI concludes that Staff's proposed sum-of-the-parts test does not go far enough to protect new entrants from potential price squeezes. (Id. at 6).

In response to CCI, Staff stated that it has some concerns regarding Mr. Pence's proposal. Staff notes that Mr. Pence was unable to determine whether the additional charges he identified would apply in an environment where CCTS purchased Ameritech Illinois' loops and ports. (Tr. 1535 line 2 to Tr. 1536 line 17). Staff is concerned that modifying the sum-of-the-parts test in the way Mr. Pence proposes would result in double counting some of the charges applicable to a new entrant. Second, because CCTS maintains a virtual collocation arrangement with Ameritech Illinois, Staff is not clear as to whether all of the additional charges would apply in a physical collocation environment. For example, in his explanation of cable pulling, Mr. Pence indicated that such a function is needed to bring CCTS' cable from a manhole outside Ameritech Illinois' office into Ameritech Illinois' office. (Tr. 1532 line 19 to Tr. 1533 line 4). Consequently, Staff is unable to make a recommendation as to whether such additional charges should be included in the sum-of-the-parts test. Finally, it appears that some of these charges may be specific to the method selected by CCTS for providing services and thus are not representative of the costs associated with providing a NAL in the straight forward method established by the sum-of-the-parts test. For example, the additional charges Mr. Pence proposes to add to the sum-of-the-parts test include charges for digital loop carriers, and charges needed to access the digital loop carriers. Based on Mr. Pence's testimony during cross examination, digital loop carriers are utilized in place of putting a thousand pair of copper cable out to a subdivision. (Tr. 1534 lines 16-22). Staff said it is not clear as to whether such charges are assessed in addition to the rate for a loop or instead of rate for that loop. As a result, Staff is again concerned that modifying the sum-of-the-parts test formulated in the Customers First proceeding, to accommodate that charge would result in double counting some of the charges applicable to a new entrant.

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Position of Ameritech Illinois

Ameritech Illinois takes the position that the sum-of-the-parts test can no longer play a valid role in evaluating the prices of unbundled network elements or interconnection. First, Ameritech Illinois states that such a test would cause Ameritech to forego the FCC's TELRIC prescribed recovery of shared and common costs in its unbundled element prices. Ameritech Ex. 1.1, p. 17. Ameritech Illinois adds that it does not have the flexibility to manipulate UNE prices such that they satisfy the sum-of-the-parts test. (AI Ex. 6.1, pp. 5-56). Second, Ameritech Illinois adds that the class of service distinctions (business vs. residential service distinctions) in retail and wholesale services do not exist in provisioning unbundled network elements. (AI Ex. 1.1, p. 17). Third, Ameritech Illinois states that the sum-of-the-parts test is not a true imputation test and that its prices could fail the sum-of-the-parts test and yet satisfy proper imputation, thereby causing no risk of a price squeeze. This is because the sum-of-the-parts test treats loops and ports as if they were both essential facilities. Ameritech Illinois argues that if both loops and ports were essential facilities, there would be no reason to sell them separately, since no buyer could produce either one, and there would be no possibility of facilities-based entry. (AI Ex. 6.1, p. 56). Fourth, Ameritech Illinois argues that the imputation requirements set forth in the PUA are more stringent than an imputation test from an economics perspective and that the sum-of-the-parts test suffers from the same drawback. (Tr. 1921, 1937).

Ameritech Illinois disagrees with Staff's recommendation that its rates for loops, ports, service coordination and cross connects be imputed into Ameritech Illinois' wholesale network access line. It argues that the purpose of an imputation test is to ensure that efficient competition is viable at the retail level. Therefore, a proper imputation test must impute the price of the essential facility to the retail price to ensure that, if the competitor could provide all of the other (non-essential) inputs, including retailing services, at a cost no greater than those of the incumbent, and adjusting for the costs of unbundling per se, the competitor could match the retail price of the incumbent. (AI Ex. 6.2, p. 18).

Ameritech Illinois also contends that use of the wholesale rate is inappropriate, because end users purchase NALs at retail rates, not wholesale rates. Further, contrary to the argument of Staff, testing wholesale NAL prices is not necessary in order to recognize the fact that Ameritech Illinois incurs retailing costs in providing a NAL. Instead, Ameritech Illinois argues that with a proper imputation cost, the retail costs of providing a NAL would be included in such a test, together with the TELRIC cost for a port, price for a loop, and proportionate share of a service coordination fee consistent with the Customers First Order. Ameritech Illinois takes the position that such a test does not accurately test for the presence of a price squeeze because it requires the summing of prices for all elements that make up a bundled service, irrespective of whether carriers purchase such elements from Ameritech Illinois or supply such elements on their own. Accordingly, a sum-of-the-parts pricing test creates

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an unnecessarily high price floor for purposes of testing for the presence of a price squeeze.

Ameritech Illinois argues that a sum-of-the-parts pricing test is inconsistent with the imputation requirements contained in Section 13-505.1. Ameritech Illinois argues that Section 13-505.1 has never been interpreted to require the imputation of prices for elements, where competitors do not pay the prices for those elements in providing a competing service. Ameritech Illinois cites the example of Centrex, where, with the approval of the Commission in Docket Nos. 92-0448/93-0239, Ameritech Illinois only imputes the prices for network access lines ("NALs") used by competing suppliers of PBXs; however, Ameritech Illinois does not impute the prices for other NALs used by Centrex service in the provision of intercom service, where competing PBX suppliers use the functionality of the PBX (instead of purchasing network access lines from Ameritech Illinois) to provide intercom calling.

Ameritech Illinois argues that while it is not opposed to imputation testing, such a requirement should only be adopted by the Commission if it is prepared to engage in the type of rate re-balancing that was envisioned by the FCC, which deferred the question of sum-of-the-parts tests and imputation tests to the states. (FCC Order, ¶ 848). Ameritech Illinois argues that the Commission cannot direct Ameritech Illinois to lower the prices for UNEs if a proper imputation test is not passed, because the lowering of such a price would not permit Ameritech Illinois to cover the prescribed amounts of costs under the Act, including forward-looking shared and common costs. Instead, the Commission must permit Ameritech Illinois to raise the price of a corresponding bundled, retail service. Ameritech Illinois argues that this is the type of "rate rebalancing" envisioned by the FCC.

Staff Response to Ameritech Illinois

Staff disagrees with Ameritech Illinois' arguments for suspending the sum-of-the-parts test. First, since the FCC's pricing standards have been stayed, until this Commission determines the pricing methodology to be applied to Ameritech Illinois' UNEs, interconnection services, transport and termination, "TELRIC prescribed recovery of shared and common costs" is not an issue. (Staff Ex. 3.02 at 23). With regard to Ameritech Illinois' arguments that the class of service distinctions (business vs. residential service distinctions) in retail and wholesale services do not exist in network elements, Staff notes that the above mentioned restriction has also been stayed. Third, although the FCC declined to impose an imputation rule on all states, it gave special weight to the comments of several state commissions, including this Commission, that currently employ imputation rules, leaving it to the states to implement such rules at their discretion. (Id. at 23).

Staff disagrees with Ameritech Illinois' conclusion that loops and ports are not essential facilities based on the fact that they are sold separately. Staff notes that network elements are sold separately because, the federal Act, the FCC Order, and the

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Commission's Order in the Wholesale proceeding (Docket 95-0458/95-0531), all require incumbent LECs to unbundle such elements and sell them to new entrants separately. The FCC Order explains the rationale behind unbundling by stating that "Congress made it possible for competitors to enter local markets through the purchase of unbundled elements because it recognized that duplication of an incumbent's network could delay entry, and could be inefficient and unnecessary. (FCC Order at 287)." (*Id.* at 25-26). Second, Staff disagrees with Ameritech Illinois' position that an input must be an essential facility in order for its rate (as opposed to its LRSIC cost) to be included in an imputation test. The imputation requirements set forth in Section 13-505.1 of the PUA require an incumbent LEC that provides both competitive and non-competitive services to impute the rates it charges its competitors for the non-competitive inputs into the rates it charges for its competitive services. The sum-of-the-parts test is consistent with the statutory imputation requirements but is extended to situations where the bundled service has not been classified as competitive. Staff notes that, in the event Ameritech Illinois' NALs are reclassified as competitive, Ameritech Illinois' loops and ports, along with the other charges associated with providing such loops and ports to competitors, will have to be imputed into its NAL rate. Since Ameritech Illinois' NAL is classified noncompetitive, imputation testing pursuant to Section 13-505.1 of the PUA is not applicable. Using the sum-of-the-parts test in place of statutory imputation requirements to protect Ameritech Illinois' competitors against price squeezes, it is equally appropriate and necessary to impute the rates Ameritech Illinois charges these competitors for loops and ports into its NAL. (*Id.* at 26-27). Third, Ameritech Illinois' arguments regarding this issue ignore the fact that Ameritech Illinois has been required by the FCC Order and the Commission's Order in the wholesale proceeding (95-0458/95-0531), to offer its network elements on an unbundled basis and to allow new entrants to rebundle these network elements to offer local service exclusively using Ameritech Illinois' UNEs.

Staff notes that from a purely economic perspective, a monopoly provider must impute the rates its charges competitors for bottleneck facilities and the LRSIC cost of non-bottleneck inputs, into the rates the monopoly provider charges for the retail service. Therefore, to the extent Section 13-505.1 requires Ameritech Illinois to impute the rates for non-bottleneck facilities that are still classified as non-competitive into its retail rates, such treatment may lead to price floors that exceed those proposed by economic theory. However, Staff notes that if Ameritech Illinois concludes that new entrants are replicating a portion of the NAL (loops and ports - the non-competitive inputs) independently, Ameritech Illinois can petition the Commission, pursuant to Section 13-502(b) of the PUA, to reclassify such portion as competitive. In that event, pursuant to the imputation standards set forth in section 13-505.1 of the PUA, Ameritech Illinois will only need to impute the LRSIC of such competitive input, to satisfy imputation requirements. (Tr. 1917 line 9 to Tr. 1918 line 16). This treatment is equally appropriate for the sum-of-the-parts test.

With respect to the use of the wholesale rate, Staff notes that Section 13-505.1(a)(3) of the PUA directs incumbent LECs to impute "any other identifiable, long-

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run service incremental costs associated with the provision of the service." Staff also notes that since the Commission's Order in the Wholesale proceeding directing Ameritech Illinois to identify its avoidable retailing costs for each of its services, Ameritech Illinois' retailing costs for services like the NAL have been identifiable. Consequently, in the event Ameritech Illinois' NALs are reclassified as competitive, Ameritech Illinois may be required to impute the LRSIC costs of its retailing costs into its retail NAL. Since the sum-of-the-parts test provides safeguards similar to those set forth in Section 13-505.1 of the PUA, it should take into account the fact that Ameritech Illinois does incur retailing costs in providing a NAL. This could be done by imputing the rates for loops, ports, etc., into the wholesale NAL, or imputing those rates, as well as a measure of Ameritech Illinois' retailing costs, into the retail NAL. For purposes of administrative ease, Staff would recommend the former.

Commission Analysis and Conclusion

The parties' positions on the sum-of-the-parts issue bring to mind familiar phrases such as "when the shoe is on the other foot," "it depends upon whose ox is being gored," and "where one stands is determined by where one sits." In Issue A, Relationship Between Wholesale and UNE Rates, Ameritech Illinois argued that there should be a relationship between the rates such that UNE rates could be no lower than the wholesale rates of the corresponding services. The company claimed this is necessary to prevent competitors from arbitraging UNE provision of service against provision of service through resold wholesale. On the other hand, potential competitors and Staff argued that there should be no mandated relationship between UNE rates and wholesale rates. We accepted the latter position and found that the two pricing standards are distinctly different under the Act.

On the sum-of-the-parts issue, however, it was the potential competitors and Staff that argued there should be a mandated relationship between UNE rates and wholesale rates. Those parties said UNE rates should not be greater than the corresponding wholesale rates. They claimed that if UNE rates are allowed to be greater than the corresponding wholesale rates the incumbent carrier could put a price squeeze on potential competitors. Apparently, a price squeeze is the flip side of arbitrage. Not surprisingly, on this issue Ameritech Illinois argued there should not be a relationship between UNE rates and wholesale rates.

We find, as we did in Issue A, Relationship Between Wholesale and UNE Rates, that the two pricing standards are distinctly different under the Act. The whole purpose of this long and arduous proceeding is to determine according to the Act the appropriate cost-based rates for various UNEs. To impose a sum-of-the-parts test could skew UNE prices away from what we have determined on this record as the appropriate cost basis (which includes the same percentage allocation of shared and common costs across all UNEs), and we do not impose such a test.

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J.. Alternative Regulation

At issue in this proceeding is whether Ameritech Illinois' proposed rates for UNEs, interconnection, transport and termination should be subject to the price cap plan under which Ameritech Illinois' non-competitive services are offered.

Position of Staff

Staff recommends that Ameritech Illinois' UNE, interconnection, transport and termination services be included in the price cap mechanism. Further, Staff recommends that such services be assigned to the Carrier basket since they are not offered to end users. To the extent any of the services addressed by sections 252(d)(1) and 252(d)(2) are currently offered by Ameritech Illinois and are included in its price cap mechanism, such services should be treated as existing services. Examples of such services are interconnection, transport and termination services. To the extent the remaining services addressed by sections 252(d)(1) and 252(d)(2) are not currently included in Ameritech Illinois' price cap mechanism, such services should be included in the Carrier basket as new services.

Staff argues that its recommendations are consistent with the framework according to which Ameritech Illinois is currently regulated as well as the treatment afforded Ameritech Illinois' wholesale services in the Resale Proceeding. (Order in Docket 95-0458/0531, June 26, 1996, at 68 and Staff Ex. 3.00 at 25).

Staff also notes that since Ameritech Illinois' rates are adjusted by the PCI, which reflects changes in Ameritech Illinois' overall costs of providing such services, it is appropriate to subject the rates of UNE, interconnection, transport and termination services to the price cap formula and associated adjustments to the PCI.

Through Ms. Yow, Staff took the position that it is appropriate to subject the rates for UNEs to a price cap formula. Staff argued that PCI adjustments provide a valid proxy for cost changes of providing services, including UNEs. Further, Staff recommended that in making UNEs subject to the price cap plan, they be made a part of the carrier basket. Under this proposal, Staff argued that when PCI adjustments are made, Ameritech Illinois will not be required to reflect such adjustments in the rates for each and every UNE. Instead, Ameritech Illinois can selectively apply rate changes, based on its understanding of the costs of providing UNEs.

Staff contended that should Ameritech Illinois conclude it needs to raise the prices of UNEs to a level not contemplated by the price cap plan, Ameritech Illinois could petition the Commission pursuant to Article IX of the Public Utilities Act and initiate a rate review proceeding.

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Staff observed that in rebuttal testimony, Ameritech Illinois agreed with Staff that exogenous factor treatment should be limited to currently existing Ameritech Illinois services, to the extent such services are affected by the Commission's prescribed rates in this proceeding. (AI Ex. 1.1 at 16-17). Staff noted that any exogenous factor change for existing services should be subject to the conditions in the Commission's Order in Docket 92-0448/93-0239 Consol.

Based on its analysis in this proceeding, Staff concluded that, to the extent the rates resulting from this proceeding affect the rates of some existing Ameritech Illinois services, such rate changes would trigger the exogenous factor treatment, because such rate changes are outside Ameritech Illinois' control. (Staff Ex. 3.00 at 27). Staff notes that a final determination as to whether rate decreases for existing Ameritech Illinois services would qualify for exogenous factor treatment, will depend on satisfying the remaining requirements set forth in the Commission's Order in Docket 92-0448/93-0239. Specifically, Ameritech Illinois will need to demonstrate that the financial effects of the rate decrease are verifiable, quantifiable and exceed \$3 million. This determination is appropriately made within the context of Ameritech Illinois' annual price cap filing.

Staff noted however, that if the Commission does grant exogenous factor treatment for rate declines to existing Ameritech Illinois services, as a result of its decisions in this proceeding, the Commission should clearly prohibit Ameritech Illinois from utilizing those rate decreases to satisfy PCI adjustments. This would allow double recovery of the lost revenues. If the Commission does not grant exogenous factor treatment for rate declines to existing Ameritech Illinois services, then according to Staff, Ameritech Illinois should be allowed to utilize those rate declines toward satisfying PCI adjustments.

Position of Ameritech Illinois

Ameritech Illinois recommends that UNEs, interconnection and transport and termination be excluded from Ameritech Illinois' alternative regulation plan. Ameritech Illinois argues that, absent a decline in the forward looking, incremental costs incurred to provide such services, subjecting the rates that result from this proceeding to price cap reductions will very likely result in rates that are below cost. (AI Ex. 1.0 at 46). To support this argument Ameritech Illinois notes that the PCI only reflects cost changes experienced by Ameritech Illinois at a very aggregate, accounting level which is not reflective of cost changes at an individual service level (AI Ex. 1.0 at 45). Ameritech Illinois adds that the PCI does not reflect cost changes completely because it includes a significant consumer dividend and a large input price differential which is not guaranteed to continue. (AI Ex. 1.1 at 16-17). The PCI also includes a service quality component that is unrelated to Company costs. (Tr. 1939 lines 1-5).

Ameritech Illinois argues that Commission should not make UNEs subject to the PCI given the mandates of the Act, which require that rates be set at their forward-

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looking long run economic cost plus a prescribed level of recovery for forward-looking shared and common costs. Instead of subjecting the prices for UNEs to the price cap plan, Mr. Gebhardt proposed that Ameritech Illinois file updates to its TELRIC studies at least annually until Ameritech Illinois' experience demonstrates stability in costs. (AI Ex. 1.1 at 16).

Finally, Ameritech Illinois points out that the Commission, when faced with product uncertainty, for example, the future of the PTC plan in Docket 92-0448, excluded them from the plan. Ameritech recommends that the same philosophy apply in this instance. (AI Ex. 1.1 at 17).

In the event the Commission rejects Ameritech Illinois' arguments, Ameritech Illinois recommends that UNEs, interconnection, transport and termination services be assigned to the carrier basket. Ameritech Illinois finds this assignment appropriate since end users will not subscribe to these wholesale priced offerings. Ameritech Illinois further concludes that this outcome is consistent with the Commission's decision in Docket 95-0458 to assign wholesale/resale services to the carrier basket. (AI Ex. 1.0 at 46).

Staff Response to Ameritech Illinois

Staff disagrees with Ameritech Illinois' contention that including Ameritech Illinois' UNEs, interconnection, transport and termination rates in the price cap mechanism will likely lead to rates that are below cost. First, although PCI adjustments do not reflect changes to the "forward looking, incremental costs" incurred to provide a given service, they do provide a proxy for changes to Ameritech Illinois' overall costs. This is because PCI adjustments are influenced by inflation, Ameritech Illinois' historical productivity and input prices, as well as costs outside Ameritech Illinois' control (exogenous adjustments). Since the costs of providing UNEs, interconnection, transport and termination services will change over time, PCI adjustments would provide a valid proxy for the cost changes in providing such services. (Staff Ex. 3.00 at 23).

Second, application of PCI adjustments to Ameritech Illinois' rates is not as restrictive as Ameritech Illinois represents it to be. When PCI adjustments are made, Ameritech Illinois is not required to reflect such adjustments in the rates of each and every service within the Carrier basket. Ameritech Illinois can selectively apply rate changes to those services that, based on its evaluation of provisioning costs, most efficiently accommodate PCI adjustments. (Id. at 23-24). Third, to the extent Ameritech Illinois finds that its rates for a UNE, for example, are too close to cost, Ameritech Illinois could increase the rates of that UNE and offset that increase by decreasing the rates for another item in the basket. (Id. at 24).

Finally, should Ameritech Illinois conclude that PCI adjustments overestimate reductions in the costs of providing UNEs, interconnection, transport and termination

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services, leading to rates that are below cost, Ameritech Illinois could propose rate changes, subject to notice and filing requirements of Article IX of the Public Utilities Act, outside the alternative regulation plan's rate adjustment mechanisms. (*Id.* at 24 and ICC Order in Docket 92-0448/93-0239 Consol., Appendix A at 4).

For the reasons described in the section on residual, Staff also disagrees with Ameritech Illinois' contention that PCI adjustments do not reflect Ameritech Illinois' cost changes completely. Staff also distinguishes the PTC plan on the basis that the subject of these proceedings is not being considered elsewhere, and it is not anticipated that the requirement that Ameritech Illinois offer such services to competing carriers will be eliminated in the near future. (Staff Ex. 3.02 at 38).

Staff opposed Ameritech Illinois' suggestion that annual cost updates be filed and reviewed by the Commission. Staff took the position that since Ameritech Illinois has been calculating long-run service incremental cost studies for a number of years, it does not seem logical that Ameritech Illinois would need an annual update process in order to provide a reasonable estimate of TELRICs.

Position of Intervenors

WorldCom witness Gillan agreed with the position of Ameritech Illinois that UNEs should not be subject to a price cap plan. He argues that UNE prices are required by federal law to be based on cost. It may be possible in the future to design a price cap formula that provides a reasonable mechanism for periodic adjustments to UNE price levels while still maintaining cost-based relationships, but at this time, there is insufficient information for the Commission to adopt such a formula, other than a tariff-wide application of a productivity factor.

Mr. Gillan concludes that if the Commission decides to apply a price cap adjustment mechanism, it would be appropriate to establish a separate basket for each individual network element. Each basket (i.e., network element price) would be adjusted for productivity. Mr. Gillan adds that Ameritech Illinois should not be provided any flexibility to strategically realign network element rates and that a requesting carrier's right to cost-based rates cannot be made secondary to a price cap provision. (WorldCom Ex. 1.2 at 26).

AT&T takes the position that the integration of UNEs into Ameritech Illinois' price cap plan must be done in a manner that is maximally procompetitive and that minimizes or eliminates Ameritech Illinois' flexibility to adjust prices among individual elements and services. AT&T adds that if UNEs are included in the carrier basket, Ameritech could strategically manage the input prices to the detriment of its competitors. To reduce or eliminate that possibility, AT&T proposes the establishment of a separate, new basket for UNEs or, preferably, a separate identical index applicable to each individual UNE rate element. (AT&T Ex. 1.1 at 8-9).

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In response, Staff argued that the creation of additional baskets is not warranted at this time. Under the current price cap plan Ameritech Illinois would have limited flexibility to raise the rates of its UNEs or strategically manage its input prices to the detriment of its competitors. This limitation was created by the Commission to address precisely the Ramsey pricing concerns raised by Messrs. Gillan and Henson in this proceeding. The Commission concluded that Ameritech Illinois should be allowed some reasonable pricing flexibility to respond to the developing marketplace and gradually restructure rates that are not economically rational. The Commission found that a 2% pricing flexibility (in addition to changes in the PCI) is appropriate for Ameritech Illinois' alternative regulation plan. (ICC Order in Docket 92-0448/93-0239 at 70 and Staff Ex. 3.02 at 33). The Commission's continued scrutiny of pricing was also a protection against abuses.

Staff observed that Ameritech Illinois' entire price cap mechanism will be reviewed by the Commission in 1998. It would be more appropriate to review the structure and content of Ameritech Illinois' baskets at that time. The one year period of experience will provide the Commission with information needed to better address that issue. (Staff Ex. 3.02 at 34).

Staff also believes that a sum-of-the-parts test will serve as an important safeguard to ensure that Ameritech Illinois does not realign its rates to an extent that would disadvantage its competitors whether intentionally or otherwise. (Staff Ex. 3.02 at 34).

Commission Analysis and Conclusion

The Commission concludes that UNEs, interconnection and transport and termination rates should be excluded, at the present time, for the alternative regulation plan currently applicable to Ameritech Illinois' noncompetitive services. Although the services are properly classified as noncompetitive under Illinois law, the passage of the Telecommunications Act of 1996 created certain significant distinctions which set these services apart from existing noncompetitive services. First, prices for these services are subject to negotiation between carriers arriving at interconnection agreements. Second, if the carriers fail to reach agreement, then the Commission must establish prices in conformity with specific standards established in the Act. Under the Act the prices must be "based on cost." This contrasts with the alternative regulation plan which, while it did not eliminate the Commission's commitment to cost-based rates, did sever the formerly strict relationship between Ameritech Illinois' rates and its operating costs. Moreover, automatic annual changes in prices under alternative regulation are based on a price formula which includes a consumer dividend and service quality component which arguably are not cost-based and may not be as relevant in the UNE environment as they are for other noncompetitive services provided to end-users.

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K.. Nonrecurring Charges

Position of Ameritech Illinois

Ameritech Illinois asserts that it must be permitted to recover all the forward-looking costs associated with the provision of UNEs and network interconnection. It contends that its recovery of these costs necessarily requires the assessment of nonrecurring charges to carrier customers. Its proposals include a service order charge, a line connection charge to recover costs associated with physically provisioning unbundled loops to new entrants, and a service coordination fee to recover nonusage sensitive components of the cost of providing switch-base service. (AI Ex. 3.1, Schedule R-6).

The service ordering process permits competing carriers to order unbundled loops (as well as other unbundled elements) from Ameritech Illinois. It developed a \$14.74 service ordering charge for unbundled loops, which it claimed was based on forward-looking labor rates and times. Mr. Palmer explained that fulfilling service orders involves an intricate interplay between electronic interfaces and human personnel. To process loop orders, the Company says it uses an electronic interface called ASR, which originally was developed to process access service requests by IXC's and their customers. The ASR interface is essentially the same as the EDI interface used for resale, except that it processes and formats different types of data.

Ameritech Illinois has calculated that the average service ordering charge for an unbundled local loop should be based on a ten-minute interval - five minutes associated with the "connect" side of the unbundled loop and five minutes associated with the "disconnect" side of the unbundled loop order. Its witness contends that the ten-minute labor time was based on its wholesale experience at its AIS customer service center in Milwaukee.

Ameritech Illinois explained that line connection charges recover the costs associated with physically provisioning an unbundled loop to a new exchange carrier. The specific steps that must be performed to provision an unbundled loop include the assignment of a cable and line pair, the forwarding of the order to the provisioning center, coordinating the loop cutover with the new exchange carrier, running the jumper to connect the loop to the new exchange carrier's facilities, and, in some cases, a field visit.

As with service ordering, its line connection process is driven by electronic interfaces, but requires additional manual intervention. As Mr. Palmer explained, manual work and coordination with the requesting carrier must supplement automated processes to perform a loop cut-over. Although computer systems are used for most of the steps necessary to complete the order, the provisioning of an unbundled loop

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requires some manual work in order to move the loop physically from its network to the new exchange carrier's network. Its TELRIC of \$15.84 reflects this mix of costs.

AT&T and MCI

AT&T and MCI note that Ameritech Illinois has included in its cost studies myriad non-recurring charges that are largely undocumented estimates of tasks performed in the ordering and provisioning of UNEs multiplied by an labor hourly rate. They observe that throughout discovery, and at the hearing, Ameritech provided no documentation to back-up the tasks and associated time intervals, which are a key factor in determining the level of the nonrecurring charges included throughout many of its studies. They claim this lack of documentation makes it impossible for the Commission to determine whether its proposals represent forward-looking processes as contemplated by the FCC's TELRIC methodology.

AT&T and MCI claim that in many cases it is impossible to validate the sources used in Ameritech Illinois' studies, or determine the assumptions upon which they are based. (AT&T Ex. 1.0P, p. 22). In addition, they observe that Ameritech's own tariff expert Mr. O'Brien, could not determine how and when certain nonrecurring charges would be assessed. (Tr. 1420). Accordingly, they questioned how this Commission or a new entrant carrier can be expected to make that determination if Ameritech cannot.

AT&T and MCI contend that Ameritech Illinois' studies are largely based on manual processes for taking service orders and do not properly reflect fully automated ordering. They argue that the Company is obligated to demonstrate with specificity how and why specific functions are necessary to provide unbundled elements. AT&T and MCI demand that every number used in Ameritech's cost study should be clearly identified, with its source readily available.

In order to rectify the shortcomings of the proposed nonrecurring charges, AT&T and MCI recommended a two-stage pricing process. Id. First, they propose that the loop and port service order charges should be set in the range of \$1 (as recommended by Dr. Ankum) to \$5 (as recommended as a ceiling by Mr. Henson). (MCI Ex. 2.0P, at 38; AT&T Ex. 1.0P, at 70-71). Dr. Ankum recommended a \$1 charge for unbundled loop and unbundled port services based on the experience of Southwestern Bell using an automated process. According to Dr. Ankum, that same amount would compensate Ameritech Illinois adequately. (MCI Ex. 2.0P at 38). Mr. Henson's \$5 ceiling is based on the FCC's current PIC change charge, which is reflective of a fully automated ordering process. (AT&T Ex. 1.0P, at 70-71). Next, AT&T and MCI propose that the Commission order Ameritech to submit a formal nonrecurring cost study to take the place of the undocumented estimates offered in this case. Prior to completion of this study, service order charges for new services, adding or changing, and making record changes should be set at a rate not to exceed \$5. Other non-recurring charges should not be instituted until Ameritech has met its burden of proof as detailed in the proposed study that they propose. Finally, they proposed that all TELRIC provisions relating to

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any nonrecurring charges be specific and clear as to how and when those charges apply, particularly with respect to any such charges that would apply when an existing Ameritech customer is converted to another carrier providing service through combinations of UNEs, including the UNE platform.

Staff

Staff agreed with Dr. Ankum that an automated service ordering process is cheaper than a manual service ordering process. In an automated process, the service ordering cost tasks of process order, log-in, screen, resolve discrepancy, format, enter and distribute will be completed largely by the new LEC's service representative when the order is initially placed. The order then will be transmitted via computer to the necessary groups in Ameritech to conduct line connection activities.

Only in unusual situations should manual intervention be necessary regarding service order charges, such as in very large orders for unbundled loops or when data is entered incorrectly. Staff testified that it would not expect this limited number of situations to cause the average service order intervention time to be as high as the ten minutes Ameritech estimates, however.

Staff did not agree with Dr. Ankum's recommendation that the Commission adopt a \$1.00 service ordering charge per unbundled loop. Staff was not persuaded that a stipulated agreement in another jurisdiction should be considered adequate evidence for a conclusion in this case. It testified that it would prefer that Ameritech recalculate its service ordering costs based on a primarily automated process.

Staff also testifies that it would be a worthwhile effort for the Company to undertake a cost study to determine what recurring and nonrecurring costs actually would be incurred in provisioning network element combinations including the platform, and to tariff those charges. (Tr. 1887-88). Staff also agreed that it would be worthwhile for Ameritech to study and tariff the nonrecurring charges which would reflect the specific work required to convert a customer from its local service to the platform service of a new entrant provider. (Tr. 1889).

In surrebuttal, the Company witness contended that the staff's witness has conducted no studies and has no relevant experience to support his opinion. He reiterated that the estimates reflects Ameritech's actual experience at its customer service center in Milwaukee.

Commission Analysis and Conclusion

There is no dispute that Ameritech Illinois will incur certain non-recurring charges in order to provision unbundled elements to new entrants, and it is entitled to recover those costs. The FCC Order suggests that the local exchange carrier should be required to "explain with specificity why and how specific functions are necessary to

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provide network elements and how the associated costs were developed." FCC Order, ¶ 691. Ameritech Illinois has failed to demonstrate that the magnitude of its proposed nonrecurring charges are appropriate. The lack of support for nonrecurring costs is apparent. Indeed, the entirety of supporting documentation for the proposed nonrecurring cost estimates were provided by Ameritech Illinois in response to an AT&T discovery request. (See AT&T Cross Ex. 19P). That documentation is extremely limited, providing only scant illumination with respect to service order and line connection charges as they apply to loops, line ports and SPNP. Of the 25 nonrecurring charges associated with unbundled local switching, Ameritech's proposed rates vary from a little less than \$16 to over \$33,000. (AI Ex. 3.1P, Schedule R-9, p. 1). Proposed charges for processes that should be similar vary significantly. For instance, the difference between the proposed service order charge for a line port and a trunk port (approximately \$16 versus over \$350, respectively) is quite significant, yet Ameritech Illinois has provided little or no explanation as to the differences in costs and activities associated with processing such service orders.

Ameritech Illinois' ten-minute service ordering charge is based on its experience in Milwaukee, which inherently includes considerable manual intervention due to the utilization of the ASR interface. It is clear from the record that the studies are not based on the use of fully automated interfaces. While Mr. Palmer claims that the labor time associated with the service order process is based on electronic interfaces, we find that claim highly questionable since the cost studies which include the labor time estimates were completed long before Ameritech Illinois implemented its Electronic Data Interchange ("EDI") interface. (AI Ex. 3.1, p. 26). As Staff testified, we do not believe that the same level of manual intervention will be required by the EDI interface which Ameritech Illinois has committed to implement. Therefore, we agree with Staff and intervenors that the cost study improperly assumes existing labor intensive processes and is inconsistent with the FCC's TELRIC methodology. Accordingly, in this instance we agree that Ameritech Illinois' proposed rates are not sufficiently forward-looking.

However, several of the alternative service ordering charges proposed by intervenors have no plausible basis. Dr. Ankum offered no alternative study or analysis of his own, instead basing his proposal for a \$1 service ordering charge on charges imposed by other carriers for other purposes in other jurisdictions, none of which have any bearing on charges for unbundled loop service orders in Illinois. Similarly, Mr. Henson's proposal for a \$5 cap is based on no submitted calculation whatsoever. Instead, we will adopt Staff's suggestion that Ameritech Illinois recalculate its service ordering costs based on a primarily automated process, and resubmit those service ordering costs for further review and approval. As an interim measure we will adopt Mr. Starkey's proposal for a service ordering charge for unbundled loops of \$13.17.

The study we are suggesting could take the form of a time and motion study. Alternatively, at Ameritech Illinois' option, an approach could be used which relies on estimates of subject matter experts. That approach should start with an identification and documentation of forward-looking workflows, identification of estimators, the

development of detailed written estimation instructions, provisions for averaging the individual estimates, development of documentation, etc.

AT&T/MCI argued that Ameritech Illinois' line connection charge is inflated due to excessive labor costs. Dr. Ankum therefore proposes a 50 percent reduction in Ameritech Illinois' labor costs, and Mr. Henson calls for formal time-motion studies. Essentially, the focus of disagreement is the time estimate for manual intervention in the coordination activity. As we indicated in our discussion of the service order charge, we are dissatisfied with the backup support for Ameritech Illinois' calculations. Accordingly, we shall adopt Dr. Ankum's suggestion that the labor estimate be reduced by 50% until such time as Ameritech Illinois provides more support for a different rate.

The service coordination fee recovers certain non-usage sensitive components of the costs of providing switch-based service. Ameritech Illinois proposed a service coordination fee of \$1.11. MCI witness Ankum stated in his direct testimony that he would not object to Ameritech Illinois' proposed fee so long as it applies on a per customer basis per central office. Mr. Palmer verified that that is precisely how Ameritech Illinois does apply the service coordination fee, and MCI withdrew its criticism. However, MCI witness Starkey identified several expenses in the service coordination study that duplicated expenses included in Ameritech Illinois' loop and port billing expenses. Ameritech Illinois conceded that it inadvertently duplicated these costs and agreed to remove them from the loop and port billing expenses.

We order that Ameritech Illinois' proposed service coordination fee be adopted, and Ameritech Illinois is directed to remove expenses also included in its loop and port billing studies from the revised cost studies that we require elsewhere in this Order.

We are also concerned that the tariff Ameritech Illinois has proposed in this proceeding makes it impossible for the Commission, new entrants and even Ameritech Illinois itself, to cogently determine how and when nonrecurring charges apply. The Commission, therefore, orders that all tariff provisions relating to any nonrecurring charges be specific and clear as to how and when those charges apply.

L.. Collocation

Position of Ameritech Illinois

The TELRIC analysis adopted by the FCC entitles the Company to be compensated for the collocation-related costs that it actually expects to incur on a forward-looking basis. To achieve this result, it determined its costs using a three-step process.

First, it determined the forward-looking recurring costs of the mere physical space that it provides to a collocater; that is, the recurring costs that are attributable

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solely to the collocator's occupation of central office space. These costs are reflected in the floor space charge.

Second, since the floor space charge does not take into account the additional expenses associated with a multiple-tenant situation or the specific needs of the equipment being deployed by the collocator, Ameritech developed a separate charge, the Central Office Build Out ("COBO") charge. This charge reflects the forward-looking incremental costs associated with configuration of interior space, development of additional means of ingress/egress to the central office and to spaces within the central office, and enhanced security, all of which are necessary to accommodate multiple tenants.

Third, the Company developed an additional charge, the transmission node enclosure charge, to compensate it for the incremental costs associated with building and maintaining the actual collocation cage.

With respect to the floor space charge, Ameritech Illinois has stated that, for a total gross building space necessary to provision 100 square feet, a total of 200 square feet is required. (AI Ex. 9.0 at 10-11). The gross-up is necessary to account for building obstructions and access space, as well as the space consumed by support functions. The 100 square feet of collocation space is the net usable space assumed to be requested by a collocator. In order to provide this Ameritech needs 150 sq. ft. of gross space in the central office equipment room itself to provide dedicated access to the transmission node and to account for building obstructions. A central office also has support areas that service the equipment room, including access halls, mechanical equipment rooms, HVAC equipment rooms, generator rooms, stairs, elevators, rest rooms and delivery areas. Ameritech calculated, based, on its actual experience, that the central office equipment room represents approximately 75% of the floor space in its central offices and the support areas represent the remaining 25%. Therefore, the related support space component allocated to the 150 feet of equipment room space is an additional 50 sq. ft.

In determining its floor space charge, the Company relied on per square foot costs for central office construction reported in. RS Means Building Construction Cost Data. The industry source utilizes present cost information to estimate the square foot cost of building a telephone exchange in the current year, based on actual reported costs incurred by contractors that have built telephone exchanges during the past ten-years. RS Means then adjusts these figures annually utilizing current cost information where applicable. Ameritech therefore proposes to charge \$670.21 per month for the rental of 100 square feet of central office space.

According to Ameritech, the costs recovered through the COBO charge represent incremental costs to accommodate collocating customers in a central office, which are in addition to and distinct from the costs of building the central office itself. For example, many of these incremental costs are associated with conditioning the